

LETTER 973

Sept. 9, 1987

THE PICTURE: There is no question but that informed investors have been distributing stocks over the last few months. How do we know that? We know it *because informed investors ALWAYS distribute stocks when yields on the blue-chip stocks sink below 3%*. But informed distribution won't immediately set off a primary bear market. No, it can take many months before distribution unleashes the bear.

We know something else. This may sound rather naive, but *a market doesn't go down until it stops going up*. Based on the market's action since August 11, I would say that there is a good chance that the stock market has stopped going up. It would appear that the upside momentum of the market has halted, and for the first time I would say that there is a strong probability that this market is rolling over.

Furthermore, in the last Letter I directed attention to the following important market events: (1) The D-J Utility Average topped out on January 22 at 227.83; (2) the advance-decline ratio (which tracks the advancing or declining tendencies of the majority of NYSE stocks) topped out on March 25; (3) the D-J Transportation Average topped out on August 11 at a record high of 1101.16. (4) the D-J Industrial Average recorded its bull market high on August 25 at 2722.42 (that may have been the ultimate bull market high -- we obviously can't know yet), and (5) the bonds (all categories of bonds) topped out in April 1986.

Now note this because it is important -- I always watch the **STRONGEST ITEM** during an extended bull market advance. As an advance progresses, the weaker items will fall by the wayside one by one. *But it is not until the strongest item finally turns down that we have the makings of a big secondary reaction or a primary bear market*. So despite the top-out of the Utilities, the A-D ratio, and the bonds, my main interest has been concentrated of late on the D-J Industrial and Transportation Averages.

In the last Letter I urged readers to keep their eyes on the August 11 peak of 1101.16 on the Transportation Average. That, I said, was the key to this market. For an all-clear signal (i.e., an upside confirmation), the Transports would have had to better the 1101.16 mark. As it turned out, we were looking in the right place. On August 25 the Dow rallied to a record high of 2722.42, but the *Transports failed (by a full 10 points) to confirm*. The next day the market turned down and by September 2 the Dow had dropped 120 points on a closing basis.

On August 28 both Averages, Industrials and Transports, broke decisively below their preceding minor lows (see page 1 chart). What was the significance of that joint penetration? In the face of an upside nonconfirmation and then a breaking of preceding minor lows, I now classify the secondary (or intermediate) trend of the market as **DOWN** -- and this for the first time since 1984.

Ordinarily, I might not take these bearish indications too seriously. But today I do take them very seriously, and this is why: (1) The August 26 downturn came with the market in the most extended position that it has ever been in. When I say extended I mean that the market has risen further (without so much as a 10% correction) than it has ever risen before. The market has also risen for a longer period of time (without so much as a 10% correction) than it has ever risen before. Finally, the August 26 downturn came with the major averages providing the thinnest yields in history.

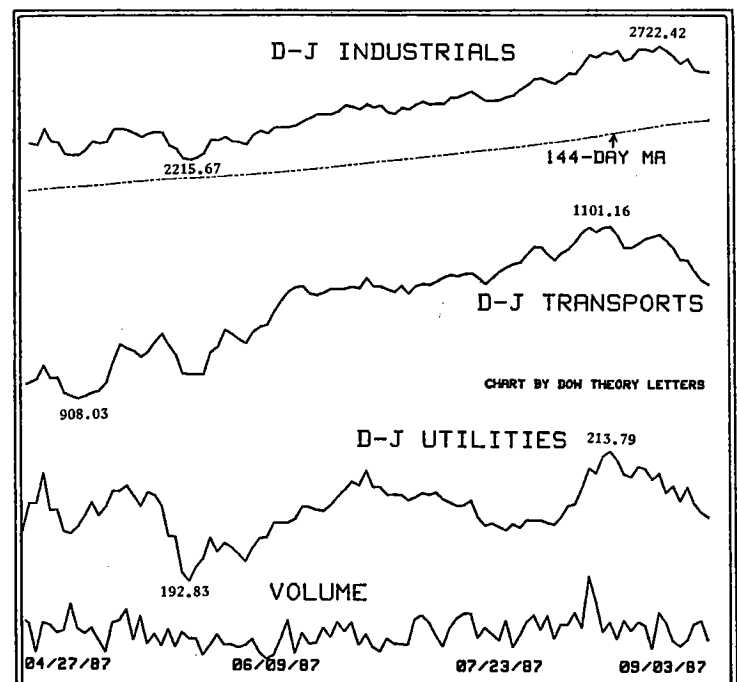
Aug. 28 DJIA 2639.35; PTI 2732; A-D Ratio -5.04
Sept. 3 DJIA 2599.49; PTI 2710; A-D Ratio -5.69

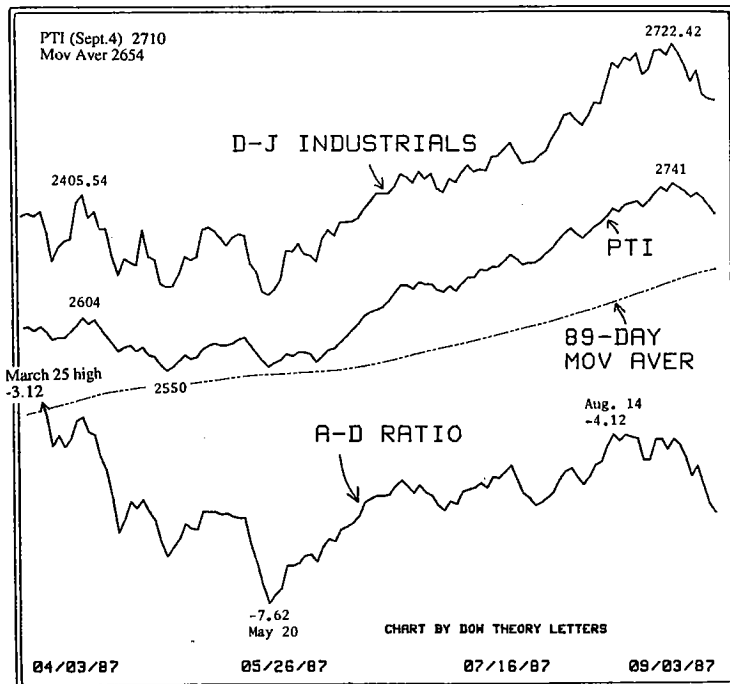
At this point no man (or woman) alive can guarantee that this is still a bull market. Nor can they tell whether the August 26 to September 1 action was just (1) a violent, quick-lived decline, (2) the beginning of a secondary reaction -- or (3) the first step in a primary bear market of indeterminate duration and extent. We just don't know what we have here, but my feeling is that at this point (after 13 years of rising prices) *preservation of capital overrides every other consideration*.

Another note of interest here. I spoke at the big ISI Conference in San Francisco. I opened my talk by asking for a show of hands (and this was on Saturday, August 29, just after the 85-point Dow decline) and my question was, "How many of you think that the market will be substantially higher in the period ahead and into 1988?" I would say that 90% of the audience raised their hands.

I think this attitude is indicative of public and professional sentiment today. There is an amazing unanimity of belief that this is still a bull market, and it's going to go a lot higher. Maybe the market is headed a lot higher, but as I've said so many times this year, our stance towards the bull market has changed. Our attitude now is that **WE'RE GOING TO MAKE THE BULL MARKET PROVE ITSELF**.

How does that work? Easy, if this is still a bull market we're going to see the D-J Industrials and Transports advance and better the 2722.42 and 1101.16 levels respectively. On the last rally the Transports failed to better 1101.16. That technical failure led to the sharp decline. But if the bull is still in charge, the Transports will have to better their previous primary high and so will the Industrials. That, very simply, is how Wall Street will prove this is (or is not) a bull market.





The PTI: If you examine the chart at the top of page 2 you will see that the PTI over recent weeks had advanced a huge distance above its 89-day moving average. In order to monitor the trend of the PTI, I use two simple criteria. (1) Is the PTI walking up a trendline, or has it broken a trendline? (2) On a longer-term basis, is the PTI fluctuating above or below its 89-day moving average?

Obviously, when the PTI is as far above its 89-day moving average as it currently is, I have to rely on trendlines for initial (i.e., more sensitive) indications of any possible downturn. Last week the PTI broke below the rising trendline extending from the June low (see page 2 chart). This action turns the PTI short-term bearish. The much larger question is whether the PTI can hold above its 89-day moving average.

The PTI advanced above its moving average in January 1985, and it has held above it (during all declines and shake-outs) ever since. At present the PTI is still 60 points above its MA. Thus, no bear market signal so far from the PTI.

Question: How far could this decline go on the downside?

Answer: This is always the first question I am asked when the market turns down. And the answer is -- there is no perfect answer. The market has not had a 10% correction since July 1984 (a record for time elapsed) so the least we might expect is a 10% correction from the August 25 Dow high of 2722. If that occurs, we could look for the Dow to come down to around 2450.

What about a full secondary correction? Full secondary corrections tend to wipe out one-third to two-thirds of the previously uncorrected primary advance. The latest advance started from Dow 1086 at the July 1984 low. A one-third correction from the August 1987 high to the 1984 low would take the Dow to around 2180.

Here's another way of figuring: Investment Quality Trends of La Jolla notes that many important corrections from overvalued peaks bring the Dow back to roughly a 4% yield basis. If this occurs, we can expect the Dow to decline to 1734, at which point it would yield 4%.

Last theoretical estimate: If this is the start of a primary bear market, we can expect the Dow to decline to the point where (based on today's dividends) it will yield at least 6%. For the Dow to yield 6%, it would have to drop back to the 1150 area.

INVESTMENT POSITION: At this point I can't prove that this is still a bull market. I thought of putting the bull in the box with both horns sheared off or putting a bear in the box with the bull. But I'm just going to leave the box empty this time, with the stipulation that if the D-J Industrials and Transports rally over 2722.42 and 1101.16 respectively, El Toro will take over the box again. Until then, I'm from Missouri as far as the primary trend of the market is concerned. In other words, "Show me."

?

At this point I would say if you hold 50% of the amount of common stocks you held at the beginning of 1987 -- that's enough. The breadth of the market continues to look poor and the Transportation Average is now almost out-of-sight on the downside as are the Utilities.

In the end, each man has to kill his own snakes. Many of my subscribers are out of this market. These "exiters" are keen judges of values, and they are convinced that there are no real values left in this market. Others have cut back but still hold some stocks. Personally, being very value-minded, I have said good-bye to the great bull. I am willing to see the Dow go to 3000 or 3500 without me. If it does "the unexpected" and drops to 1500 or 1000, I'll call myself lucky or prescient or brilliant and let it go at that.

QUESTIONS & ANSWERS: Question: Russell, a year or so ago all anybody on Wall Street talked about was the latest M-1 or M-2 statistics. Now all they talk about is the dollar. What's happening?

Answer: For decades, as the US federal deficits built up, nobody seemed to worry about the debt picture. Liberals consoled that "we owe it to ourselves, so why worry?" and although this was a stupid response, there was at least a kernel of truth in it. But now the huge trade deficits have emerged, and suddenly we are the world's biggest international debtors. But this is a horse of a different color. *Now we owe the money to foreigners. For the first time in modern history, the US is not the master of its financial fate.*

Furthermore, current US prosperity is based on "the kindness of strangers" (i.e., foreigners loaning us money). The fact is that 20% to 40% of every Treasury auction is taken up by foreign (mostly Japanese) buyers. Without this massive foreign buying, our bond markets would collapse.

Creditors of the US (who own huge amounts of US bonds) are obviously focused on the dollar. When the dollar declines, these creditors lose tremendous amounts of capital. At some point, if the dollar continues to decline, foreigners will panic and stop buying US paper -- or worse, they will start selling our paper. We don't even want to think about what happens then.

Last week the bond market plunged and yields on long-term T-bonds rose to the 9.5% levels on some issues. With the Dow's yield at 2.6% and the yield of the broad S&P 400 Industrials at 2.4%, the yield spread in favor of bonds over stocks becomes intolerable. Result: the stock market dives and stock yields push higher. *Thus, the dollar controls bonds, and bonds in turn exert tremendous pressure on stocks.* This, in a few nutshells, is why Wall Street is now obsessed with the dollar. And well it should be. Remember this: we don't just owe it to ourselves any more, we owe it to the world.

Question: What good is the study of values when the market keeps climbing? You've talked a lot lately about values, but I make my money on price appreciation in a stock, not on whether any given stock is a value.

Answer: I don't know how many investors I've met and talked to in this business -- probably thousands. And I can say this: The ones I've met who have really made money are the ones who have

had a plan. I can't remember a single successful investor who had a haphazard approach to the market. In other words, the successful, big money investors always have a method.

Values tell you where you are in a bull (or bear) market. They give you a guidepost. As a rule, it's very hard to buy (psychologically speaking) at a bear market bottom when values are great. It's hard because fear is also great. By the same token, it's very hard to sell in a bull market when values are thin. It's hard because greed is the dominant emotion. But having a knowledge of the yield (i.e., value) cycle is a big help to the investor who has a policy of only buying great values and always selling thin values. The value-oriented policy, by the way, has made more investors rich than any method I know of. With few exceptions, most wealthy men and women are shrewd judges of values -- in the market, in their own businesses, and elsewhere.

Question: You used to talk about "buying stampedes." How is it that you never labeled the 1987 action a buying stampede?

Answer: I define a buying stampede as any advance of five points or more in the A-D ratio, uncorrected by an intervening decline of one point or more. We did see a buying stampede in the market between December 31, 1986 and March 23, 1987, at which time the A-D ratio rose an uncorrected 5.23 points. The A-D topped out on March 23 and then dropped 4.50 points to a May 20 low. That drop wiped out 86% of the previous buying stampede gains (see A-D ratio on the page 2 chart).

Few people realize it, but since the May 20 low the A-D ratio has risen only 3.60 points, and it has accomplished this in an irregular unimpressive fashion. As of today, the A-D ratio is more than two full points away from its March 23 high.

However, from May 20 to August 25 the A-D line for the 30 Dow stocks climbed better than five points without an intervening one-point correction (although the stampede ended last week). Therefore (and I've never seen this before) I guess we'd have to call 1987's action a strict blue-chip buying stampede without an accompanying buying stampede in the rest of the market.

Question: Do you think the secondary and non-blue-chip stocks are going to join the upward parade? Or to put it another way, how long can the majority of stocks continue to stay out of this bull market?

Answer: I guess I haven't really addressed the problem of the secondary issues. The reason I haven't is because from an investment standpoint, I haven't recommended them, and I therefore haven't been that fascinated with them. I have felt all along that this was going to be a blue-chip bull market advance, and that's the reason I repeatedly advised my subscribers to buy and stay with (only) the big, Dow-type issues.

So far that approach has been the correct one. The big money and the big moves have been made by the Dow-type stocks. Will this change? Many leading analysts are predicting that it will, but I'm skeptical. I think one of the frustrations of this bull market has been (and will continue to be) that the big stocks are too expensive for the public to buy and the secondary stocks are not going to be the money-makers.

Question: Russell, I note that you are talking a lot about bonds, and you are constantly making comparisons between stocks and bonds. Why?

Answer: The yield on the Dow is now 2.52%. The yield on the D-J 20 Bond Average is 10.02%. The yield spread in favor of bonds is now a huge 7.50% in favor of bonds. This massive spread renders stocks particularly sensitive to any further bond decline, since any bond decline simply makes the stock/bond yield spread that much more larger in favor of bonds.

Here's another way of looking at it. The price/earnings ratio for the Dow is now 21.5. The earnings "yield" for the Dow is 4.65 (the

earnings yield is the reciprocal of the P/E ratio, so simply divide 100 by 21.5 to obtain the earnings yield).

Bonds don't have earnings (instead they have coverage), but they do have a payout or yield. The yield on the highest-grade bonds, the US Treasury bonds, runs around 9.5%, and this is considered the safest return obtainable on any security.

The interest on T-bonds is now twice the earnings yield on the Dow (remember, not the dividend yield but the earnings yield on the Dow). So in order for the earnings yield on the Dow to equal the yield on T-bonds, the Dow earnings would have to double! Thus, from a pure value standpoint the Dow is tremendously overpriced compared with the outstanding safety and return on T-bonds.

Question: How do bull markets actually end? You keep talking about non-confirmations and so forth, but what can we really look for?

Answer: Maybe I can answer that question best with a story I was told 30 years ago. A broker calls his client and says, "Herb, I just spoke to the president of US Steel. I mean I spoke to the man himself. He told me that Big Steel is running at absolute capacity, their order books are filled, and next year is guaranteed to be their best year ever."

Herb immediately tells his broker, "Sell all my Steel at the market." The broker is amazed. "What are you doing, Herb? I just told you that US Steel was in fantastic shape."

Herb replies, "I heard you. You were really saying that business at Big Steel can't get any better. But what you know, the market already knows. If it can't get any better at Big Steel, it can only get worse. Therefore, it's time to sell." So Herb sold his Steel. And he got out a few points from the top.

People don't seem to understand the concept of the primary trend, which is the great, all-powerful, major trend of the market. Today, everyone is watching the sentiment figures, the bullish consensus, the put/call ratios, the inflation statistics, the money supply. What they don't understand is that once the primary trend turns down, everything else (all those supplementary studies) become of secondary importance.

When the primary trend turns down it means that the market is going to go lower in a series of descending peaks and lows, and the only question is the pattern and timing of those declining peaks and lows. In a bear market, technical strength implies nothing more than a coming rally. On the other hand, technical weakness implies new bear market lows. But the overall direction of a bear market will be persistently and stubbornly down, and all rallies will simply be moves against the prevailing major bear trend.

I have stated in previous Letters that because this bull market has taken the form of a parabolic rise, I was of the opinion that the advance would continue higher with little or no real correction -- until a spear-point bull market top was reached. Then, when the price action finally turned down I thought we would be in a primary bear market -- although I was sure that most people would (initially) welcome the downturn. They would simply label it "a correction in the bull market."

In other words, I thought that this bull market was heading straight to wherever it was going, and when it finally toppled over we would find ourselves in a bear market. That, by the way, is why I felt that it was necessary to take profits as this bull market climbed higher. It is a heck of a lot easier to sell on the upside when people are eager to buy your stocks than it is to sell in a falling market when bids are drying up and when everyone wants "out."

Question: Russell, I notice that the yield spread between the Treasury bonds and the high-grade municipal bonds has closed considerably. Why?

Answer: Easy, the supply-demand situation for munis was very unfavorable during 1986 due to the huge amount of muni offerings plus a great deal of confusion over the tax laws. Both

situations have now been cleared up. In fact, if there are to be any changes in the tax laws (and there could be), the changes would surely be on the order of the government reneging on the schedule to lower rates for high-income investors.

Question: We hear a lot these days about how the public is still bearish and are not in this market. What do you think about this?

Answer: Suddenly everyone is a contrary opinion expert. I have grown exceedingly careful about using sentiment indicators, since they have become so widely used by almost every analyst (on Wall Street as everywhere else, "too many cooks spoil the broth"). But I do know that the public is in the markets in a huge way via the mutual funds plus the closed-end funds. There is presently about \$800 billion of public money in roughly 2,100 mutual funds, and I am told that a new fund is brought out every day of the year. Therefore, to my mind, it's rather stretching the truth to say that "the public is not in the market."

What does frighten me a little is the thought of how these funds will fare in the next primary bear market. We know that at some point in a bear market the public wants "out." This will entail redemptions by the funds in a major and perhaps unprecedented way. At some point in the next bear market, it would not surprise me to see a time when the exchanges will have to be closed because of illiquidity (dearth of buy orders).

Question: Russell, I note that in talking about valuation for the market, you invariably emphasize dividend yield over price/earnings ratios. Why?

Answer: Earnings are often open to question. Or as the old Wall Street adage runs, "earnings are what your accountant says they are." But dividends entail a real cash outlay by a corporation. Furthermore, corporations do not pay out dividends or boost dividends (or cut them, for that matter) lightly. No corporation wants to be labeled as "flaky" or unstable, and one sign of stability is a consistent dividend policy.

Dividends represent the actual return on the investment to the investor. Any long-term study of earnings as against dividends will show that earnings fluctuate much more wildly than dividends. Thus dividend yield on an historical basis presents a much more solid, stable criterion for appraising value than do earnings.

A good example of this can be illustrated via a paragraph from Marty Zweig's latest report. Marty writes: "This graph shows the S&P P/E ratio after adjusting earnings for the effects of inflation on inventory and depreciation. The adjusted P/E is now up to about 17. That's fairly high, but if real earnings merely stayed the same, the market would have to rise another 38% to match the P/E peaks of 1962. Such a move would theoretically take the Dow to over 3700, and even more if earnings were to rise in the interim. In other words, 'overvaluation' is a difficult concept to pin down."

Right, Marty, overvaluation is extremely hard to pin down -- if you use P/E ratios. That's why the classic test of overvaluation is dividend yield. There's no fudging, no adjusting needed when you use dividend yields. The Dow is now providing a dividend yield of 2.52%. That's less of a return on the investment than anything we have seen at any of the tops in this century. In other words, a 2.52% yield on the Dow represents overvaluation, pure and simple.

Question: What happens if we go into a bear market accompanied by a wide-open collapse in the dollar? Where are the islands of safety if something like this occurs?

Answer: If we go into a bear market (and I've thought about this a lot), I believe, as things stand today, there are five major islands of safety. They are (1) cash, (2) T-bills which I consider to be tantamount to cash, (3) gold bullion and gold coins, (4) gold stocks, (5) foreign currencies, and here my choice would be the Swiss franc.

Few of the above require "how-to" explanations. In the gold share department, my No. 1 choice at this time would be Newmont Gold (NGC) listed on the NYSE. A good friend of mine who is an outstanding analyst tells me that NGC's gold reserves are vastly understated.

As for foreign currencies, you can always buy the futures or the actual foreign cash (the latter through your bank). But here's a new and interesting twist. The Global Cash Portfolio (it's listed as International Cash in the mutual fund columns of your newspaper) allows you to invest in the yen, Swiss franc, mark, pound, and Aussie dollar. You can also switch from currency to currency with this fund. There is a 1.25% front-end load charge when you buy the fund, but no charge for selling. For information call 1-800-232-3310 or 213-312-3289.

Question: I read that program selling was mainly responsible for the big stock market break of the past few weeks. What do you think?

Answer: Program selling (or buying) is of no importance to long-term investors. All program selling can do is add violence to a move. But the direction of the primary trend of the market is the important consideration, and program sellers can in no way alter that trend.

Let's liken the primary trend of the market to the long-term moving average (MA) of any broad stock average. When the primary trend turns down the MA will slowly but relentlessly decline. The daily action of the stock average may fluctuate violently above or below the declining MA, but the MA will always pull the average to lower levels.

Buying and selling programs will have the effect of making the swings above or below the MA that much faster and wilder, but the MA will nevertheless control the overall trend.

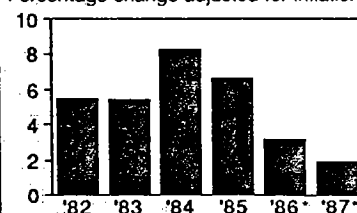
NOTES & QUOTES: Does Wall Street love a bull market? You better believe it does. In the last 10 years in NYC the Street has hired 82,000 people, bringing the total to 152,000 as of June (BLS figures). Interesting fact: Between 50% and 60% of the Street's work force was not around during the last (1973-74) bear market. Between 1974 and '79 nobody was hiring, and the street spent its time cutting staff.

How big is Sears? Answer: VERY BIG. Half the households in the US carry a Sears credit card (I know I do). Twenty-five million families owe Sears an average of just under \$600 each. Sears' \$45 billion in yearly sales represents 1.05% of the US GNP. Sears distributes 330 million catalogues a year. Sears is the fourth biggest advertiser in the US.

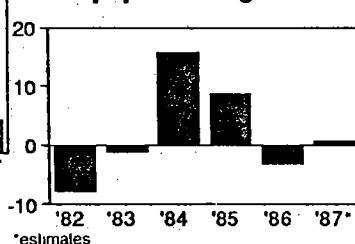
Is the US interested in the long pull or in fast profits? Judge for yourself via these two charts. And then again, the new law eliminates the investment tax credits. So the fact is that the US is going for consumerism, big spending, and fast profits. As for long-range planning, I guess we'll have to leave that to the Japanese.

R&D spending slows down . . .

Percentage change adjusted for inflation



. . . as investment in plant and equipment sags



Source: Data Resources Inc.

* *
It is well-known that in 1929, some margin accounts were as low as 10%, and this was (in retrospect) thought to be a major reason for the horrendous bear market of 1929-32. But consider this: The estimated margin today on a S&P 500 futures contract is \$10,000, and this controls roughly \$167,000 of S&P stocks (at current prices). Thus the current margin on the S&P contract is 5.9%.

Today the Stock Exchange has been "commoditized" via the various stock average futures. Furthermore, banks now encourage margin loans on mutual funds. It's the "mortgaging of Wall Street" and it dwarfs the 1929 situation. It promises to make the next primary bear market a beaut.

* *
The yen has become an important international currency. The net outflow of capital from Japan has sky-rocketed from \$19 billion in 1983 to \$84 billion in 1986. Euro-yen bonds are becoming popular, and US borrowers, who have traditionally borrowed in dollars, are increasingly favoring yen borrowing (at lower interest rates). Noting the picture, the Japanese government has been easing its regulations and the trend has been increasingly toward making Japan's markets international in scope.

* *
Does it pay to be a sports idol? I'd say so. Here are some of the leading idols with their recent annual takes in endorsements alone: Boris Becker (tennis) \$5 million, Michael Jordan (basketball) \$4 million, Greg Norman (golf) \$4 million, Jim McMahon (football) \$3 million, Dennis Conner (sailing) \$1.8 million -- and by the way, the next America's Cup is almost sure to be in San Diego.

* *
From our "High Life Dept.": Rolex raised its prices another 7% on its gold watches. And the Central Selling Organization (owned by DeBeers, and seller of almost all diamonds including Russian diamonds) has raised the price of rough diamonds twice in the last year and is rumored to be ready to raise prices another 12% shortly.

* *
Last week my wife, Faye, started law school at the University of San Diego. I showed Faye the chart below, but nothing's going to stop her. She told me that the only women who are safe in this country are lady wrestlers, pistol experts, and lawyers.

	Lawyers	
	Total	Per 100,000 people
Japan	13,200	11
US	655,000	279
Britain	64,100	114
W Germany	47,300	77
France	15,800	29

* *
There are very few times when I have bought a stock on the basis of my personal experience with the product (frankly, I have always believed that anything that I know about a company is already reflected in its market price). But I did buy Merck last year on the basis of a new "miracle drug." The drug is Mevacor (generic name, Lovastatin), a cholesterol-lowering drug that the FDA just approved.

I have always had high cholesterol (around 350 to 370). Yes, I tried the Pritikin diet and every other low-fat diet, and I am one of those 1-out-of-5 people that does not respond to diet. As readers know, I ended up with a by-pass operation in July 1986 (as a matter of interest, I feel great now, better, in fact, than I did five years ago).

About 10 months ago I went on a special experimental cholesterol-lowering program at UCSD under a doctor-researcher's supervision. The drug was Merck's Mevacor. In 10 months my cholesterol count dropped from a high 371 to last month's 181. To me, that's a miracle. With Merck's Mevacor going on the market, I would expect that it will bring in hundreds of millions of new sales dollars to Merck (and Merck, in my opinion, will deserve it).

Now let's turn to finance: Merck will earn roughly \$7.75 next year, so the stock is selling for a fat 26.6 times next year's earnings. Consequently, Merck has an earnings yield (not dividend yield but earnings yield) of about 3.76%. Merck is planning on a billion dollar buy-back of its own stock. But Merck could get a better return for its billion by buying T-bills (it could probably earn 5% after taxes) than it will earn retiring its own stock. So does it make sense to buy back one's own stock in today's market? In most cases, I don't think it does. Particularly when a stock's earnings yield is substantially lower than what the company could obtain if it invested at prevailing short-term interest rates.

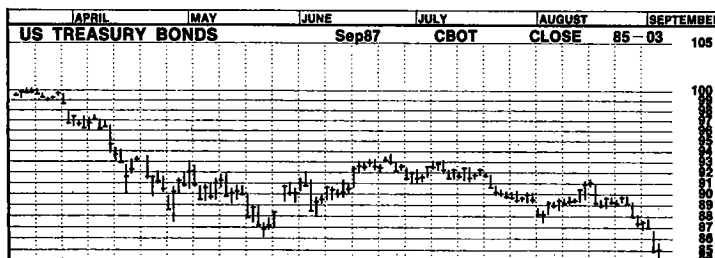
* *
I'm probably the only advisory publisher who subscribes to the Hollywood Reporter. Why? Because I have two daughters in show business. One (Daria) works as an assistant producer at PBS TV here in San Diego. The other (Betsy) is an actress in Hollywood. Betsy has been in four movies so far (she's done it all on her own), and she's starred in two of them. Last week she called to tell me that she just got a fifth movie, and she's the lead (name of the film is a secret). I don't pretend to understand how the crazy film business works; all I know is that being an actor is super-competitive, very tough on your ego, and extremely hard work. Anyway, here's a recent pic of Betsy. Last time I ran a picture of her (back in 1984) I got more mail in a week about Betsy than I usually get in a month about the stock market. Mmm.



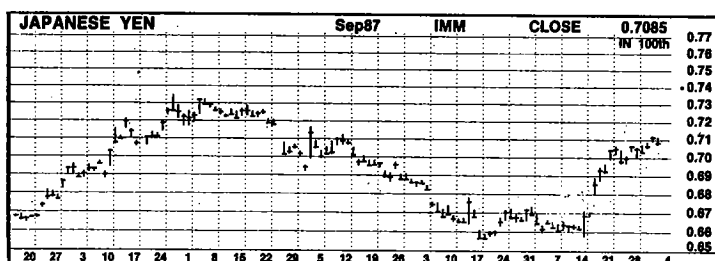
* *
Yeah, the right has had it with Ronald Reagan. His endorsement of the wimpy peace plan set forth by Central American presidents is bringing screams from conservatives. The WSJ cried "Fiasco!" in an editorial entitled "Bay of Pigs." William Safire saw "appeasement" and other conservatives called it a sell-out of the Contras. But Danziger of the Christian Science Monitor came up with a classic cartoon that said more than any of the angry conservatives. I couldn't resist including it here.



TRENDS: Bonds: Don't ask! Last week the bonds got hit again -- hard. The reason, if that makes anyone happier, is the weak dollar. The September bond contract broke below its May support at 86. The gap between munis and T-bonds has now closed considerably. For California subscribers who are muni buyers, it's frustrating because the Cal munis have not come down that much in price. There are obviously a lot of Californians who don't like to pay taxes.



The yen has exploded off its August low, and in doing so it has made up most of the ground it lost to the dollar on its May-August slide. Will the yen move to new highs against the dollar? Everybody says that's what has to happen. Some gurus are even talking about a further 30% slide in the dollar. It could happen, but the current bearishness towards bonds and the dollar is overwhelming. Can all those guys be right? Can the obvious happen? We'll see.

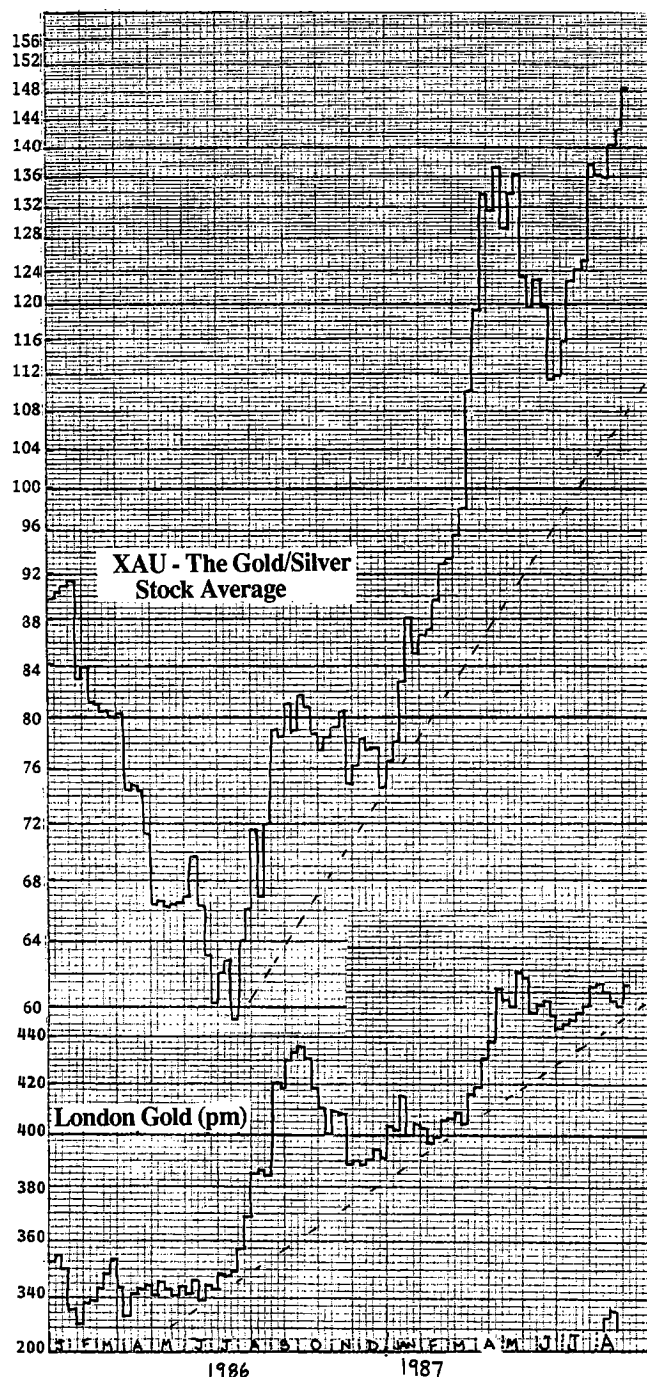


GOLD: There's a gold rush on. From Australia to Canada to the US men are searching (and finding) gold. Furthermore, advanced technology is working for the gold men, and the cost of producing gold has been lowered considerably (in some cases down to \$200 an ounce). You can sell all the gold you produce, and the yellow metal doesn't go at a discount. Consequently, gold mining is a hot business today.

Because of all of the above, the world's production of gold is rising rapidly. Isn't this going to result in an oversupply of gold? Hardly, the real oversupply is of paper money, not gold. Furthermore, people the world over are becoming increasingly suspicious of paper money, and they have contracted a new disease -- the "screaming goldies" (that's a Russell expression). The symptoms are these: People rushing to buy gold coins, gold jewelry, gold bathtub fixtures, gold rimmed glasses, gold watches (by the carload), gold ... well, you name it.

The two charts on this page tell the story. Both gold bullion and the gold/silver average (made up of half gold and half silver shares) are in bull trends. In the case of the gold average (XAU) the trend is so steep that I wonder if it can be sustained.

In the past I have recommended (and I still like them) some of the no-load gold funds such as Lexington (800 526 0057) or Financial Strategic Gold (800 525 9831) or United Services Gold (800 824 4653). As I reported in an earlier section, one of my smartest friends, a guy who lives with his nose in stocks reports, tells me that the real buy today is Newmont Gold (NGC) on the NYSE. NGC's gold reserves, he tells me, are vastly understated.



LATE NOTES: On September 4 the Fed raised the discount rate from 5.5% to 6%. The announced reason for the Fed raise was to fight inflation. If you believe that, you also believe the San Diego Chargers will win the Super Bowl. No, the real reason the Fed raised the discount rate is to defend the weak dollar (and, of course, the dollar has been playing havoc with the bond market, and if the bond market goes to hell Uncle Sam isn't going to sell any of his mountain of T-bonds).

The problem is that raising the discount rate is just popping a band-aid on the REAL problem, which is the deficits. Thus, without Congress' help, it remains for the Fed alone to defend the dollar. But in the end fundamentals will always win over manipulation, and as far as I'm concerned, the Fed's messing around with interest rates amounts to mere manipulation. The fundamentals are the US debts and deficits, and nobody's doing a damn thing about them.

NEXT MAILING: Sept. 23